

TIMPANOGOS SPECIAL SERVICE DISTRICT

(A Component Unit of Utah County)

BASIC FINANCIAL STATEMENTS

and Reports in Accordance with *Government Auditing Standards*
and the *State of Utah Legal Compliance Audit Guide*

Years Ended December 31, 2005 and 2004

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INDEPENDENT AUDITOR'S REPORT

Administrative Control Board Chair and Board Members
Timpanogos Special Service District

We have audited the accompanying basic financial statements of Timpanogos Special Service District (the District), as of and for the years ended December 31, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of District management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Timpanogos Special Service District as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 8, 2006, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Management's discussion and analysis on pages 2 through 4 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America and the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Squire & Company, PC

June 8, 2006

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
Management's Discussion and Analysis

As management of Timpanogos Special Service District (the District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal years ended December 31, 2005 and 2004. We encourage readers to consider the information presented here in conjunction with the financial statements and notes.

Financial Highlights

The assets of the District exceeded its liabilities at the close of the most recent fiscal year by \$50.2 million (net assets). Of this amount, \$6.2 million (unrestricted net assets) may be used to meet the District's ongoing obligations to participating cities and customers, employees, and creditors.

The District's total net assets increased by \$10.1 million in 2005 and \$7.6 million in 2004. Most of these increases are attributable to impact fees received from new connections during the years.

Overview of the Financial Statements

The financial statements consist of three separate statements, which are similar to a private-sector business. The Statements of Net Assets present information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases and decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The Statements of Revenues, Expenses, and Changes in Net Assets present information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in these statements for some items that will only result in cash flows in future fiscal periods (e.g., uncollected fees charged and earned but unused vacation leave).

The Statements of Cash Flows presents the activities of the District on a cash-received and cash-paid basis. This statement shows how cash was spent and reconciles the change in the cash accounts for the District from the prior year to the current year.

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of the District's financial position. Assets exceeded liabilities by \$50.2 million at the close of the most recent fiscal year.

The tables on the following page summarize information presented in the financial statements:

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
Management's Discussion and Analysis

Timpanogos Special Service District's NET ASSETS
December 31, 2005, 2004, and 2003

| | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|--|----------------------|----------------------|----------------------|
| Current assets | \$ 6,782,358 | \$ 7,261,440 | \$ 5,898,015 |
| Capital assets | 44,418,451 | 45,011,897 | 46,267,290 |
| Other assets | <u>35,667,014</u> | <u>25,675,272</u> | <u>19,251,853</u> |
| Total assets | 86,867,823 | 77,948,609 | 71,417,158 |
| Current liabilities | 2,255,534 | 1,925,943 | 1,573,966 |
| Long-term liabilities | <u>34,451,284</u> | <u>35,952,842</u> | <u>37,395,409</u> |
| Total liabilities | 36,706,818 | 37,878,785 | 38,969,375 |
| Net assets invested in capital assets, net of related debt | 8,314,176 | 7,465,055 | 7,682,881 |
| Net assets restricted for debt service and capital improvements | 35,625,033 | 25,673,291 | 16,915,281 |
| Unrestricted net assets | <u>6,221,796</u> | <u>6,931,478</u> | <u>7,849,621</u> |
| Net assets | <u>\$ 50,161,005</u> | <u>\$ 40,069,824</u> | <u>\$ 32,447,783</u> |

Timpanogos Special Service District's CHANGE IN NET ASSETS
Years Ended December 31, 2005, 2004 and 2003

| | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|----------------------------------|----------------------|----------------------|----------------------|
| Operating revenues | \$ 6,480,488 | \$ 5,558,679 | \$ 5,001,509 |
| Operating expenses | <u>5,304,838</u> | <u>4,905,094</u> | <u>4,613,959</u> |
| Operating income | 1,175,650 | 653,585 | 387,550 |
| Nonoperating revenues (expenses) | <u>8,915,531</u> | <u>6,968,456</u> | <u>8,891,081</u> |
| Change in net assets | 10,091,181 | 7,622,041 | 9,278,631 |
| Net assets, beginning of year | <u>40,069,824</u> | <u>32,447,783</u> | <u>23,169,152</u> |
| Net assets, end of year | <u>\$ 50,161,005</u> | <u>\$ 40,069,824</u> | <u>\$ 32,447,783</u> |

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
Management's Discussion and Analysis

The largest portion of the District's net assets (71 percent at December 31, 2005) reflects its investment in assets restricted for debt service and capital improvements. These assets will be used over time to make debt service payments. The net assets representing investments in capital assets net of related debt

consists of land and easements, building, wastewater treatment plant, interceptor lines, and equipment and fixtures less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to participating cities and customers; consequently, these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The remaining balance of unrestricted net assets (\$6.2 million at December 31, 2005) may be used to meet the District's ongoing obligations.

In comparison with the prior years, the following items should be noted:

Operating revenues increased by 17 percent in 2005 and 11 percent in 2004 primarily from growth in the number of customers.

Nonoperating revenues for impact fees totaled \$10.1 million during 2005 and \$8.3 million during 2004, an increase of \$1.8 million during 2005 and a decrease of \$2.2 million during 2004. These changes were attributable to changes in the number of new connections and connection fees. The change in net assets for 2005 was \$10.1 million as compared to a net income of \$7.6 million in 2004 and \$9.3 million in 2003.

Other assets increased by \$10.0 million during 2005 and \$6.4 million in 2004, which reflects the receipt of unspent impact fees, restricted for debt service and capital improvements.

Capital Asset and Debt Administration

At the end of the current fiscal year, the District had total capital related debt of \$38.3 million. All capital-related debt outstanding is revenue bonds and a capital lease and is scheduled to be retired by December 2019 and 2009, respectively.

Economic Factors and Next Year's Budgets and Rates

The District prepared its 2006 budget anticipating nominal overall growth in gallons of wastewater treated over the next year. Basic wastewater treatment fee expense is not expected to increase in 2006.

The District continues to actively pursue economical, innovative methods of treating and processing wastewater.

Requests for Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the District Manager, Garland Mayne, at P.O. Box 293 American Fork, Utah 84003.

BASIC FINANCIAL STATEMENTS

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
STATEMENTS OF NET ASSETS

December 31, 2005 and 2004

| | 2005 | 2004 |
|--|----------------------|----------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and investments | \$ 4,637,108 | \$ 5,604,912 |
| Accounts receivable | 2,114,041 | 1,622,294 |
| Inventory | 2,760 | 2,760 |
| Prepaid expenses | 28,449 | 31,474 |
| Total current assets | 6,782,358 | 7,261,440 |
| Capital Assets: | | |
| Land and easements | 2,017,807 | 2,017,807 |
| Construction in progress | 324,728 | - |
| Depreciable, net of accumulated depreciation | 42,075,916 | 42,994,090 |
| Net capital assets | 44,418,451 | 45,011,897 |
| Other Assets: | | |
| Deposits | 41,981 | 1,981 |
| Restricted cash and investments | 35,625,033 | 25,673,291 |
| Total other assets | 35,667,014 | 25,675,272 |
| Total assets | 86,867,823 | 77,948,609 |
| LIABILITIES | | |
| Current Liabilities: | | |
| Current portion of bonds payable | 1,759,000 | 1,594,000 |
| Current portion of obligation under capital lease | 38,376 | - |
| Accrued interest | 205,659 | 216,964 |
| Accounts payable | 123,591 | 71,566 |
| Accrued liabilities | 128,908 | 43,413 |
| Total current liabilities | 2,255,534 | 1,925,943 |
| Long-Term Liabilities: | | |
| Obligation under capital lease | 106,009 | - |
| Bonds payable, less current portion | 34,345,275 | 35,952,842 |
| Total liabilities | 36,706,818 | 37,878,785 |
| NET ASSETS | | |
| Invested in capital assets, net of related debt | 8,314,176 | 7,465,055 |
| Restricted for debt service and capital improvements | 35,625,033 | 25,673,291 |
| Unrestricted | 6,221,796 | 6,931,478 |
| Total net assets | <u>\$ 50,161,005</u> | <u>\$ 40,069,824</u> |

The accompanying notes are an integral part of these statements.

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Years Ended December 31, 2005 and 2004

| | 2005 | 2004 |
|--|----------------------|----------------------|
| Operating Revenues: | | |
| Waste water treatment income | \$ 6,130,639 | \$ 5,265,492 |
| Compost sales and green waste fees | 335,393 | 275,763 |
| Miscellaneous revenues | 14,456 | 17,424 |
| Total operating revenues | 6,480,488 | 5,558,679 |
| Operating Expenses: | | |
| Personnel | 1,865,569 | 1,654,360 |
| Depreciation and amortization | 1,481,191 | 1,576,202 |
| Repairs and maintenance | 617,742 | 352,846 |
| Utilities | 579,522 | 617,933 |
| Compost expense | 272,992 | 233,763 |
| Professional services | 223,855 | 242,541 |
| Chemicals and supplies | 151,234 | 87,347 |
| Insurance | 35,518 | 54,444 |
| Office expense | 32,256 | 34,152 |
| Telephone | 20,555 | 17,291 |
| Vehicle expenses | 19,877 | 27,195 |
| Laundry | 4,527 | 7,020 |
| Total operating expenses | 5,304,838 | 4,905,094 |
| Operating Income | 1,175,650 | 653,585 |
| Nonoperating Revenues (Expenses): | | |
| Impact fees | 10,057,652 | 8,322,648 |
| Interest income | 1,163,250 | 633,182 |
| Interest expense | (2,306,571) | (1,987,374) |
| Gain on the sale of assets | 1,200 | - |
| Total nonoperating revenues (expenses) | 8,915,531 | 6,968,456 |
| Change in Net Assets | 10,091,181 | 7,622,041 |
| Net Assets at Beginning of Year | 40,069,824 | 32,447,783 |
| Net Assets at End of Year | <u>\$ 50,161,005</u> | <u>\$ 40,069,824</u> |

The accompanying notes are an integral part of these statements.

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
STATEMENTS OF CASH FLOWS
Years Ended December 31, 2005 and 2004

| | 2005 | 2004 |
|--|----------------------|----------------------|
| Cash Flows from Operating Activities: | | |
| Cash received from customers | \$ 5,988,741 | \$ 5,558,679 |
| Cash paid to suppliers | (1,943,028) | (2,164,294) |
| Cash paid to employees and for benefits | (1,780,074) | (1,654,360) |
| Net cash provided by operating activities | 2,265,639 | 1,740,025 |
| Cash Flows from Capital and Related Financing Activities: | | |
| Interest paid | (2,317,876) | (2,001,233) |
| Impact fees collected | 10,057,652 | 8,322,648 |
| Purchase of capital assets | (591,927) | (169,376) |
| Principal payments on bonds | (1,594,000) | (1,189,000) |
| Proceeds from the sales of assets | 1,200 | - |
| Net cash provided by capital and related financing activities | 5,555,049 | 4,963,039 |
| Cash Flows from Investing Activities: | | |
| Interest received | 1,163,250 | 633,182 |
| Net Increase in Cash and Cash Equivalents | 8,983,938 | 7,336,246 |
| Cash and Cash Equivalents at Beginning of Year | 31,278,203 | 23,941,957 |
| Cash and Cash Equivalents at End of Year | \$ 40,262,141 | \$ 31,278,203 |

Supplemental Information:

A reconciliation of operating income to cash flows provided by operating activities follows:

| | 2005 | 2004 |
|--|--------------|--------------|
| Operating income | \$ 1,175,650 | \$ 653,585 |
| Depreciation and amortization | 1,481,191 | 1,576,202 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (491,747) | (459,727) |
| Prepaid expenses | 3,025 | 9,129 |
| Deposits | (40,000) | - |
| Accounts payable | 52,025 | (6,723) |
| Accrued liabilities | 85,495 | (29,785) |
| Retention payable | - | (2,656) |
| Net cash provided by operating activities | \$ 2,265,639 | \$ 1,740,025 |

The District financed the purchase of equipment in the amount of \$144,385 by assuming a capital lease of the same amount during the year ended December 31, 2005.

There were no noncash financing, capital and investing activities during the year ended December 31, 2004.

The accompanying notes are an integral part of these statements.

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
NOTES TO BASIC FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

The accounting policies of Timpanogos Special Service District (the District) are in compliance with generally accepted accounting principles applicable to local governmental units. The following is a summary of the more significant policies.

The Reporting Entity - Timpanogos Special Service District is organized as a special service district in Utah County. The District's purpose is to provide sewage treatment and disposal services and facilities for participating cities and customers. The District is a component unit of Utah County.

The District accounts for its operations as an enterprise (proprietary-type) fund; activities are financed and operated in a manner similar to private business enterprises where the intent of the Board is that the costs (expenses, including depreciation) of providing goods or services to members and the general public on a continuing basis be financed or recovered primarily through user charges.

Basis of Accounting - The financial statements are maintained on the accrual basis of accounting, under which revenues are recognized in the period in which they are earned and become measurable, and expenses are recorded in the period incurred if measurable. The District applies all applicable FASB pronouncements in accounting and reporting its proprietary operations to the extent those standards do not conflict with or contradict guidance of the Government Accounting Standards Board.

The District distinguishes operating revenues and expenses from nonoperating items by whether or not transactions are related to the District's purpose of providing wastewater treatment and disposal services and facilities.

Accounts Receivable - Accounts receivable from customers primarily represent assessments to member cities and impact fees collected by member cities. No allowance for doubtful accounts has been established; the District considers all amounts collectible.

Inventory - Inventory consists of an estimate of parts and supplies on hand, valued at the lower of cost or market.

Capital Assets - Capital assets are recorded at cost. Capital assets, except land and easements, are depreciated using the straight-line method over the estimated useful lives of the assets as follows:

| | |
|----------------------------|---------------|
| Building | 40 years |
| Wastewater treatment plant | 50 years |
| Interceptor lines | 7 to 50 years |
| Equipment and fixtures | 5 to 15 years |

Upon the sale or retirement of capital assets, the related asset costs and accumulated depreciation are removed from the applicable accounts and gain or loss on disposal is recorded.

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
NOTES TO BASIC FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies (Continued)

Compensated Absences - Employees are granted vacation and sick leave in amounts varying with tenure. In the event of termination or death, an employee or beneficiary is reimbursed for accumulated vacation days. Employees are also reimbursed for earned but unused sick leave within certain guidelines. At December 31, 2005 and 2004, accrued compensated absences totaled \$66,860 and \$10,228, respectively.

Employees who retire with unused sick time can receive health insurance payments for up to 18 months. The potential obligation for this benefit is insignificant.

Comparative data for the prior year have been presented in order to provide an understanding of the changes in financial position and operations. Certain amounts presented in prior year data have been reclassified in order to be consistent with the current year's presentation.

Note 2. Deposits and Investments

The District follows the requirements of the Utah Money Management Act (Utah Code Annotated 1953, Title 51, Chapter 7) in handling its depository and temporary investment transactions. This law requires the depositing of District funds in a "qualified depository" defined as any financial institution whose deposits are insured by an agency of the federal government and which has been certified by the Commissioner of Financial Institutions as meeting the requirements of the Act and adhering to the rules of the Utah Money Management Council. Each calendar quarter, the Council provides a list of qualified depositories to each public treasurer; the Council establishes the maximum amount of public funds that each qualified depository is eligible to hold.

The Act authorizes the District to invest in certificates of deposit, U.S. Treasury obligations, U.S. agency issues, high-grade commercial paper, banker's acceptances, repurchase agreements, certain corporate bonds, State of Utah and local government obligations, and restricted mutual funds as defined by the Act and to invest in the Utah Public Treasurers' Investment Fund (PTIF). The PTIF is not registered with the Securities and Exchange Commission as an investment company and deposits in the PTIF are not insured or otherwise guaranteed by the State of Utah. The PTIF operates and reports to participants on an amortized cost basis. The operating income, gains, and losses of the PTIF are allocated to each participant based upon each participant's average daily balance.

Deposits - The District's carrying amount of bank deposits at December 31, 2005, is \$3,445,415, and the bank balance is \$536,818 (\$200,000 of which is covered by federal depository insurance). Uninsured deposits are not collateralized.

Investments - At December 31, 2005, the District had a balance of \$36,816,726 in the PTIF. The investment is unrated and has an average maturity of less than one year.

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
NOTES TO BASIC FINANCIAL STATEMENTS

Note 2. Deposits and Investments (Continued)

Credit Risk – Credit risk is the risk that the counterparty to an investment will not fulfill its obligations. The District's policy for limiting the credit risk of investments is to comply with the Utah Money Management Act.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The District manages its exposure to declines in fair value by investing mainly in the PTIF and by adhering to the Utah Money Management Act. The Act requires that the remaining term to maturity of investments may not exceed the period of availability of the funds to be invested.

Custodial Credit Risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The District's investment policy is to follow the Utah Money Management Act and to invest mainly in the PTIF. The District's investment policy does not limit the amount that can be held by counterparties.

At December 31, 2005 and 2004, the District's investment balances were as follows (each investment is recorded at fair value):

| | <u>2005</u> | <u>2004</u> |
|--|----------------------|----------------------|
| Investment in Utah Public Treasurers' Investment | | |
| Fund not subject to categorization | <u>\$ 36,816,726</u> | <u>\$ 27,746,090</u> |

Total deposits and investments as described above as of December 31, 2005 and 2004 are as follows:

| | | |
|--------------------------------|----------------------|----------------------|
| Carrying amount of deposits | \$ 3,445,415 | \$ 3,532,113 |
| Carrying amount of investments | <u>36,816,726</u> | <u>27,746,090</u> |
| Total cash and investments | <u>\$ 40,262,141</u> | <u>\$ 31,278,203</u> |

A recap of cash and investments as shown on the balance sheets at December 31, 2005 and 2004, is as follows:

| | <u>2005</u> | <u>2004</u> |
|--|----------------------|----------------------|
| Current assets - cash and investments | \$ 4,637,108 | \$ 5,604,912 |
| Other assets - restricted cash and investments | <u>35,625,033</u> | <u>25,673,291</u> |
| Total cash and investments | <u>\$ 40,262,141</u> | <u>\$ 31,278,203</u> |

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
NOTES TO BASIC FINANCIAL STATEMENTS

Note 2. Deposits and Investments (Continued)

In accordance with revenue bond requirements, the District maintains various restricted cash and investment accounts for bond debt service, bond sinking, emergency repairs and replacements, and construction.

The District considers all its cash and investments to be cash and cash equivalents for the purpose of the statements of cash flows.

Note 3. Capital Assets

During the year ended December 31, 2005, the following changes occurred with respect to capital assets:

| | Balance at Dec. 31, 2004 | Additions | Deletions | Balance at Dec. 31, 2005 |
|--|-----------------------------|--------------|-----------|-----------------------------|
| Capital assets not being depreciated: | | | | |
| Land and easements | \$ 2,017,807 | \$ - | \$ - | \$ 2,017,807 |
| Construction in progress | - | 324,728 | - | 324,728 |
| Capital assets being depreciated: | | | | |
| Building | 1,195,592 | - | - | 1,195,592 |
| Wastewater treatment plant | 44,628,104 | - | - | 44,628,104 |
| Interceptor lines | 10,908,431 | - | - | 10,908,431 |
| Equipment and fixtures | 1,963,330 | 411,584 | (50,861) | 2,324,053 |
| Total capital assets being depreciated | 58,695,457 | 411,584 | (50,861) | 59,056,180 |
| Accumulated depreciation for: | | | | |
| Building | (166,885) | (29,890) | - | (196,775) |
| Wastewater treatment plant | (9,546,377) | (918,606) | - | (10,464,983) |
| Interceptor lines | (3,395,027) | (222,588) | - | (3,617,615) |
| Equipment and fixtures | (2,593,078) | (158,674) | 50,861 | (2,700,891) |
| Total accumulated depreciation | (15,701,367) | (1,329,758) | 50,861 | (16,980,264) |
| Net capital assets being depreciated | 42,994,090 | (918,174) | - | 42,075,916 |
| Net capital assets | \$45,011,897 | \$ (593,446) | \$ - | \$44,418,451 |

Note 4. Bonds Payable

Revenue Bonds - The District has issued bonds where the District pledges revenues to service the debt. Revenue bonds outstanding are reported net of unamortized deferred bond costs (amortization of deferred bond costs is charged to amortization expense over the life of the bonds using a straight-line method). Amortization expense for the years ending December 31, 2005 and 2004, totaled \$151,433 for each year. These bonds carry interest rates from 3.85 to 6.1 percent.

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
NOTES TO BASIC FINANCIAL STATEMENTS

Note 4. Bonds Payable (Continued)

Bonds payable for the year ended December 31, 2005, is summarized as follows:

| | Balance at Dec. 31, 2004 | Additions | Deletions | Balance at Dec. 31, 2005 | Due Within One Year |
|-------------------------------|-----------------------------|-------------|---------------------|-----------------------------|------------------------|
| Bonds payable: | | | | | |
| Revenue bonds | \$ 39,730,000 | \$ - | \$ 1,594,000 | \$ 38,136,000 | \$ 1,759,000 |
| Deferred amounts on refunding | (2,183,158) | - | (151,433) | (2,031,725) | - |
| Total bonds payable, net | <u>\$ 37,546,842</u> | <u>\$ -</u> | <u>\$ 1,442,567</u> | <u>\$ 36,104,275</u> | <u>\$ 1,759,000</u> |

A summary of principal debt requirements to maturity for the years following December 31, 2005, are as follows:

| Year Ending December 31, | Principal | Interest | Total |
|-----------------------------|----------------------|----------------------|----------------------|
| 2006 | \$ 1,759,000 | 1,844,751 | \$ 3,603,751 |
| 2007 | 2,130,000 | 1,748,640 | 3,878,640 |
| 2008 | 1,781,000 | 1,650,103 | 3,431,103 |
| 2009 | 1,897,000 | 1,568,403 | 3,465,403 |
| 2010 | 1,999,000 | 1,467,230 | 3,466,230 |
| 2011-2015 | 12,105,000 | 5,694,360 | 17,799,360 |
| 2016-2019 | 16,465,000 | 1,967,875 | 18,432,875 |
| Total | <u>\$ 38,136,000</u> | <u>\$ 15,941,362</u> | <u>\$ 54,077,362</u> |

Defeasance of Debt - On May 15, 1998, the District defeased certain revenue bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the District's financial statements. At December 31, 2005, \$32,760,000 of bonds outstanding is considered defeased.

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
NOTES TO BASIC FINANCIAL STATEMENTS

Note 5. Capital Leases

Capital leases for the District consisted of a new lease for equipment. The following is the capital lease activity for the year ending December 31, 2005:

| | <u>Balance at</u> <u>Dec. 31, 2004</u> | <u>Additions</u> | <u>Deletions</u> | <u>Balance at</u> <u>Dec. 31, 2005</u> |
|--------------------------------|---|------------------|------------------|---|
| Obligation under capital lease | \$ - | \$ 144,385 | \$ - | \$ 144,385 |

Future minimum capital lease payments are as follows:

| <u>Year Ending</u> <u>December 31,</u> | <u>Annual</u> <u>Obligation</u> |
|---|------------------------------------|
| 2007 | \$ 44,515 |
| 2008 | 44,515 |
| 2009 | 68,807 |
| | <u>157,837</u> |
| Amount representing interest | <u>(13,452)</u> |
| Present value of net minimum lease payments | <u>\$ 144,385</u> |

Note 6. Retirement Plans

Defined Benefit Plan - The District contributes to the Local Government Noncontributory Retirement System and the Local Government Contributory Retirement System, cost-sharing multiple-employer defined benefit pension plans administered by the Utah Retirement Systems (Systems). The Systems provides retirement benefits, annual cost of living allowances, and death benefits and refunds to plan members and beneficiaries in accordance with retirement statutes established and amended by state legislature.

The Systems are established and governed by the respective sections of Chapter 49 of the Utah Code Annotated 1953 as amended, which also establishes the Utah State Retirement Office (Office) for the administration of the Systems and Plans. Chapter 49 places the Systems, the Office and related plans and programs under the direction of the Utah State Retirement Board whose members are appointed by the Governor. The Systems issue a publicly available financial report that includes financial statements and required supplementary information for the Systems and Plans. A copy of the report may be obtained by writing to the Utah Retirement Systems, 540 East 200 South, Salt Lake City, UT 84102 or by calling 1-800-365-8772.

In the Local Government Contributory and Noncontributory Retirement Systems, the District is required to contribute a percentage of their annual covered salary (all or part may be paid by the employer). The contribution rates are the actuarially determined

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
NOTES TO BASIC FINANCIAL STATEMENTS

Note 6. Retirement Plans (Continued)

rates. The contribution requirements are authorized by statute and approved by the Utah State Retirement Board.

The following is a summary of the required contribution rates, covered salaries, and District contributions to the Systems for the years ended December 31, 2005, 2004, and 2003:

| | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|--|---------------|---------------|---------------|
| <u>Required contribution rates:</u> | | | |
| Contributory System - Local Government Division | | | |
| Paid by employer | 7.08% | 5.61% | 4.68% |
| Paid by employer for employee | <u>6.00%</u> | <u>6.00%</u> | <u>6.00%</u> |
| Total | <u>13.08%</u> | <u>11.61%</u> | <u>10.68%</u> |
| Noncontributory System - Local Government Division | <u>11.09%</u> | <u>9.62%</u> | <u>8.69%</u> |
| <u>District contributions:</u> | | | |
| Contributory System - Local Government Division | \$ 8,747 | \$ 7,015 | \$ 5,783 |
| Noncontributory System - Local Government Division | 123,021 | 103,907 | 90,265 |
| <u>Salary subject to retirement contributions:</u> | | | |
| Contributory System - Local Government Division | 66,874 | 56,667 | 51,907 |
| Noncontributory System - Local Government Division | 1,109,292 | 1,001,472 | 985,977 |

Deferred Compensation Plan - The District participates in a deferred compensation plan—under Internal Revenue Code Section 401(k)—to supplement retirement benefits accrued by participants in the Systems. Employees covered by the Local Government Noncontributory Retirement System have a contribution made by the District to the 401(k) plan. During the years ended December 31, 2005, 2004, and 2003, employer contributions totaled \$31,315, \$38,168, and \$47,033, respectively, to the 401(k) plan. The 401(k) plan funds are fully vested to the participants at the time of deposit. Plan assets are held by the Utah Retirement System.

Note 7. Economic Dependency

The District has contracted with its members, exclusively, to receive, treat, and dispose of the members' municipal wastewater. In the event that members, for economic or environmental reasons, were unable to continue using the District's facilities, the District would be susceptible to risk of closure.

TIMPANOGOS SPECIAL SERVICE DISTRICT
(A Component Unit of Utah County)
NOTES TO BASIC FINANCIAL STATEMENTS

Note 8. Risk Management

The District maintains insurance coverage for general, automobile, personal injury, errors and omissions, employee dishonesty, and malpractice liability up to \$1,000,000 per occurrence through policies administered by the Utah Local Governments Trust. The District also insures its buildings, including those under construction, and contents against all insurable risks of direct physical loss or damage with the Utah Local Governments Trust. This all-risk insurance coverage provides for repair or replacement of damaged property at a replacement cost basis subject to a deductible of \$1,000 per occurrence. Settled claims have not exceeded the District's insurance coverage for any of the past three years.

The District also maintains a public treasurer's fidelity bond of \$500,000 with a private carrier. All District employees are covered for workers' compensation by the Utah Local Governments Trust. Unemployment insurance is covered by the District on a pay-as-you-go basis. Claims have been minimal for the past three years.

Note 9. Environmental Remediation Liability

The nature of the District's operations is such that the District may be held liable for environmental clean-up costs. The District is unaware of any such issues and has taken extensive measures to prevent future environmental problems caused by its operations. The costs of potential remediation are not estimable since no knowledge of environmental problems currently exists. Therefore, no liability has been accrued.

Note 10. Commitments

The District is obligated to perform wetlands remediation as a part of the West Side Plant Expansion completed in 1999. The current estimate of the wetlands remediation is \$685,489 for Phase II. The District is under no obligation to complete the wetlands remediation in the near term.

**REPORTS IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS
AND THE STATE OF UTAH LEGAL COMPLIANCE AUDIT GUIDE**

Year Ended December 31, 2005



**Independent Auditor's Report on Internal Control
Over Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in Accordance
with Government Auditing Standards**

**Administrative Control Board Chair and Board Members
Timpanogos Special Service District**

We have audited the basic financial statements of Timpanogos Special Service District (the District) as of and for the year ended December 31, 2005, and have issued our report thereon dated June 8, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to management of the District in a separate letter dated June 8, 2006.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board, management, and oversight agencies and is not intended to be and should not be used by anyone other than these specified parties.

Squire & Company, PC

June 8, 2006

Squire & Company, PC
Certified Public Accountants and Business Consultants



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**Independent Auditor's Report on Legal Compliance in Accordance with the
State of Utah Legal Compliance Audit Guide**

**Administrative Control Board Chair and Board Members
Timpanogos Special Service District**

We have audited the basic financial statements of Timpanogos Special Service District, as of and for the year ended December 31, 2005, and have issued our report thereon dated June 8, 2006. Our audit included test work on the District's compliance with the general compliance requirements identified in the *State of Utah Legal Compliance Audit Guide*, including:

| | |
|--|---------------------------------|
| Cash Management | Purchasing Requirements |
| Budgetary Compliance | Other General Compliance Issues |
| Special Districts | Public Debt |
| Impact Fees and Other Development Fees | |

The District did not receive any major or nonmajor state grants during the year ended December 31, 2005.

The management of the District is responsible for the District's compliance with all compliance requirements identified above. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financials audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed immaterial instances of noncompliance with the requirements referred to above, which are described in the accompanying management letter. We considered these instances of noncompliance in forming our opinion on compliance, which is expressed in the following paragraph.

In our opinion, Timpanogos Special Service District complied, in all material respects, with the general compliance requirements identified above for the year ended December 31, 2005.

Squire & Company, PC

June 8, 2006



Letter to Management

June 8, 2006

Administrative Control Board Chair and Board Members
Timpanogos Special Service District

In planning and performing our audit of the basic financial statements of Timpanogos Special Service District for the year ended December 31, 2005, we considered the District's internal control to determine our auditing procedures for the purpose of expressing an opinion on the basic financial statements and not to provide assurance on internal control. We also included test work on the District's compliance with the general compliance requirements identified in the *State of Utah Legal Compliance Audit Guide*.

During our audit we became aware of the following immaterial instances of noncompliance with state requirements and matters that are opportunities for strengthening internal control and operating efficiency. This letter does not affect our report dated June 8, 2006, on the basic financial statements of Timpanogos Special Services District. Many of these comments are matters that are repeated from prior-year letters to management.

Accounting Records, Bookkeeping, and Reporting – Not all prior year audit adjusting journal entries were made to adjust accounts to their proper balances. The 2004 audit entries were made in July of 2005 instead of December 2004. This means the District's records do not match the financial statements as of December 31, 2004.

Several PTIF accounts should be consolidated since the purpose for these accounts has been completed. In addition, with the implementation of the District's in-house accounting system, all PTIF statements should be sent to the District to facilitate the reconciliation of these accounts.

The District's in-house accounting system has not been completely implemented and does not provide necessary information to the District. The District should ensure that the accounting system works properly to record transactions and provide accurate information for timely decision making.

The implementation of an in-house accounting system no longer requires the use of an outside accountant for many of the recordkeeping and accounting functions. We recommend that all wastewater treatment fees be remitted to the District office. Receipt of these fees can then be immediately recorded in the accounting system, providing the District with more accurate information. The District should ensure a proper segregation of duties and review of cash receipts processed by the District.

Impact Fees – The District was unable to provide information necessary to recalculate the impact fees received from the cities which varied from the standard \$2,480 connection fee. We recommend a standardized remittance form be used that clearly identifies how impact fees are to be assessed. Periodic reviews of city records and training of city personnel are also encouraged.

Also, some cities have not remitted impact fees promptly to the District and the 18% finance charge was not assessed. We recommend that the District enforce its current policies regarding late payment to encourage the quick remittance of impact fees.

Restricted Cash and Investments – The District has adopted an impact fee specifically to pay for the construction costs or debt service on debt issued to finance construction. The District should reconcile the collection, use, and remaining balances of these impact fees to ensure these fees are spent for their intended purposes. We also recommend the District adopt a policy of using restricted resources before using unrestricted resources when appropriate, i.e. paying debt service and construction costs from restricted amounts.

Investing Policies – The District has invested over \$3 million in 5-year certificates of deposit (maturing in March 2008) with a local financial institution. Only \$100,000 of these deposits are insured; the remainder is uninsured and is not collateralized by the institution. Following is an excerpt from the *State of Utah Legal Compliance Audit Guide* regarding cash management:

Selection of investments shall be made with the exercise of that degree of judgment and care under circumstances then prevailing that persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital, as well as the probable benefits to be derived (*Utah Code 51-7-14*). Also, public treasurers should meet the following objectives when investing public funds: (1) safety of principal; (2) need for liquidity; (3) yield on investments; (4) recognition of the different investment objectives of operating and permanent funds; and (5) maturity of investments, so that the maturity date of the investment does not exceed the anticipated date of the expenditure of funds. (*Utah Code 51-7-17*).

The District's investments comply with current state requirements. The District, however, should establish written investment policies and appoint a committee to monitor investing activities often to ensure the District's objectives and policies are being met. We also recommend the District ensure that all investments are properly collateralized.

Budgeting – The District's annual budget and daily records are prepared on a cash basis of accounting. The District's financial statements are prepared on the accrual basis of accounting. We recommend the budget be prepared and the books be maintained on the same basis of accounting used to prepare the financial statements. One basis of accounting will simplify budgeting, recordkeeping, and reporting. A single basis of accounting will facilitate the understanding of the District's financial position and activities.

3-Day Rule – The District did not comply with the State's law for depositing funds within 3 days of receipt. The District should make deposits daily when cash is received, but in no case should the deposit be made more than 3 days from the time when funds are received.

Management's Response – We appreciate the comments received. We will review these matters and make adjustments as needed. We will continue to implement our in-house accounting system. We believe that maintaining the accounting for the District internally will remedy a number of the comments identified in this letter.

The status of these comments will be reviewed in your next financial audit. Management should resolve these matters as soon as practical. We have discussed these comments with District personnel and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing recommendations. We appreciate the assistance of District personnel in our audit.

Sincerely,

Squire & Company, PC

Squire & Company, PC